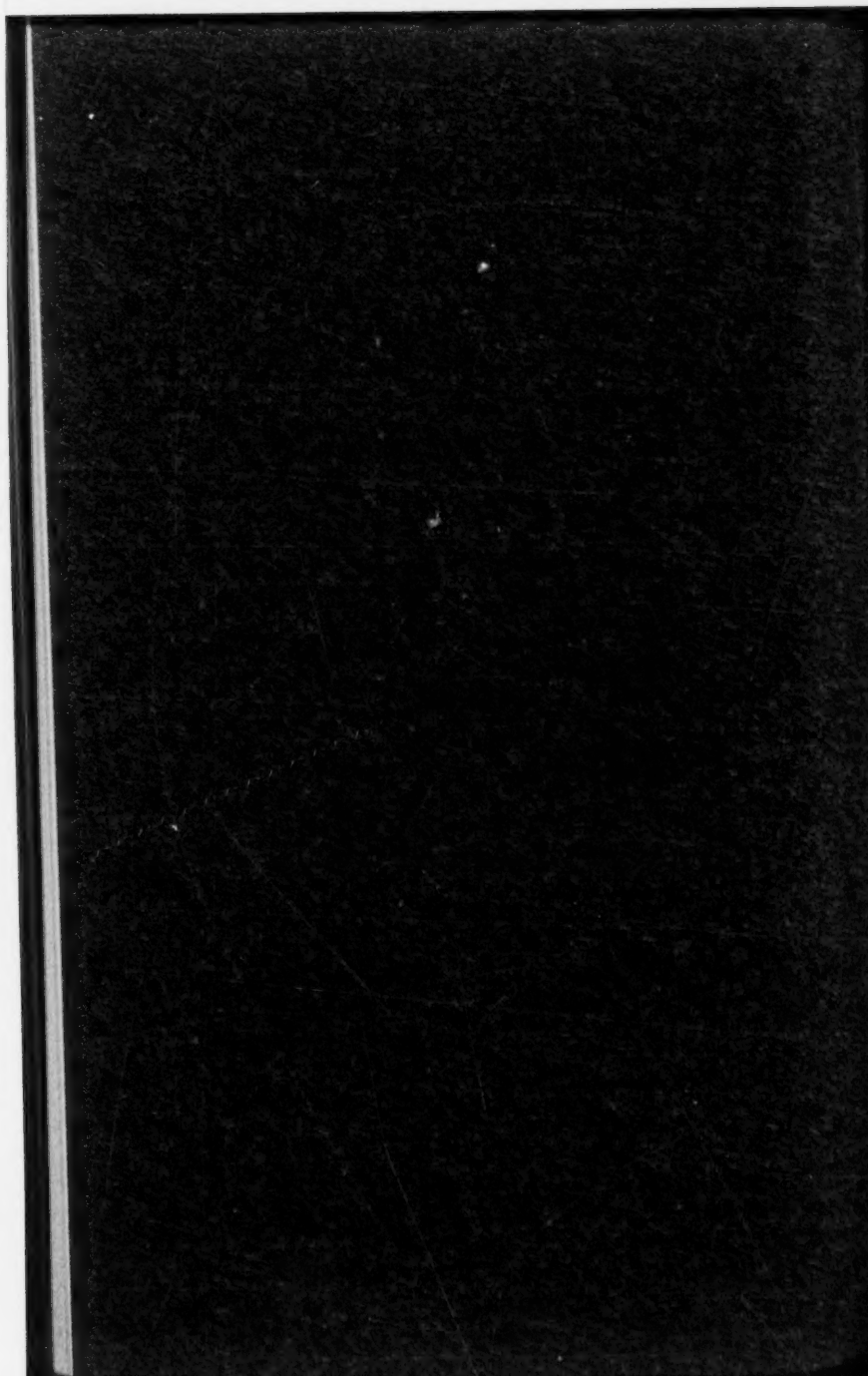


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# In the Supreme Court of the United States.

OCTOBER TERM, 1922.

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SIMON HECHT AND SUMMIT L. HECHT, Trustees, petitioners, v. JOHN F. MALLEY, FORMER COLLECTOR OF Internal Revenue.	}	No. 532.
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ARTHUR L. HOWARD AND ROBERT S. Barlow, Trustees, petitioners, v. JOHN F. MALLEY, FORMER COLLECTOR OF Internal Revenue.	}	No. 533.
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ARTHUR L. HOWARD AND ROBERT S. Barlow, Trustees, petitioners, v. ANDREW J. CASEY, FORMER ACTING COL- lector of Internal Revenue.	}	No. 534.
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*ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT  
COURT OF APPEALS FOR THE FIRST CIRCUIT.*

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## BRIEF ON BEHALF OF RESPONDENTS.

These writs of certiorari bring up for review judgments of the Circuit Court of Appeals for the First Circuit reversing judgments of the District Court for

the District of Massachusetts. The suits were brought against former collectors of internal revenue for refunds of capital stock excises paid under protest. The District Court decided in favor of the plaintiffs, and its judgments were reversed by the Circuit Court of Appeals. (281 Fed. 363.) The petitioners are trustees of so-called Massachusetts Trusts, and the question involved is whether these trusts are taxable as associations under the revenue acts of 1916 and 1918.

#### STATEMENT OF THE CASE.

Two trusts are involved, that in No. 532 being the so-called Hecht Trust, and that in Nos. 533 and 534 being the so-called Haymarket Trust.

#### The Hecht Trust.

This trust was regarded by the Circuit Court of Appeals and by counsel below as the strongest case for the plaintiff. That court said (p. 88):

On superficial examination this organization looks somewhat like a family affair, making provision for members of the Hecht family immature or otherwise unfitted for business responsibilities. But on analysis we find the organization is a very genuine business concern.

In 1899 members of the Hecht family holding as tenants in common title to real estate in the city of Boston conveyed it to Jacob Hecht upon an agreement which is set forth on pages 52 to 61 of the record. Certificates for 1,000 shares were issued to members of the Hecht family in accordance with

their proportionate interests. Each share is for one-thousandth of the beneficial interest in the property held by the trust and has no par value. The shares are represented by certificates in form like stock certificates (p. 70), transferable only on the books of the trustee, in person or by attorney, and some of the shares have been transferred. There is a restriction upon the transfer of the certificates in favor of lineal descendants of Elias Hecht, and in certain contingencies they are to be offered the trustee before being sold to an outsider. This restriction is analogous to the close-corporation provision considered in *New England Trust Co. v. Abbott*, 162 Mass. 148. Annual statements have been sent to the shareholders, and the letters of the trustee to shareholders inclosing returns from the investment described them as dividends (p. 72). The statements show capital, undivided profits, and surplus (pp. 72-74), and the statement of December 31, 1919, shows a capital of \$1,462,292.20 and surplus of \$136,500.

Under the trust agreement the trust is to be known as the Hecht Real Estate Trust, and is to continue until 20 years after the death of Jacob H. Hecht unless sooner terminated as therein provided (p. 54). The trustees shall hold the property and in general have full powers of management (pp. 56, 57) but no power to create any personal liability on the shareholders (p. 58). The trustees may at any time appoint one or more cotrustees, and the shareholders may at any time, by instrument in writing executed

by holders of not less than three-fourths of all the shares, direct that the number of trustees be increased. Any trustee may be removed by instrument in writing by holders of record of not less than three-fourths of all the shares. Every new trustee, except as above provided, shall be appointed by instrument in writing by the remaining trustees, or, if there is no remaining trustee, by instrument executed by the holders of at least three-fifths of the shares. These provisions are subject to the exception that Louis Hecht, jr., and Marcus H. Hecht, successively, shall succeed Jacob H. Hecht (p. 58). By paragraph 12 of the agreement (p. 59) "*this declaration of trust may, at any time, be modified in any particular, and this trust may at any time be terminated, and any instructions may at any time be given to the trustee hereunder by instrument in writing and under seal, signed, sealed, and acknowledged, as required for the acknowledgment of deeds, by the holders of record of not less than three-fifths of all the shares.*" This latter provision obviously gives to the shareholders a large measure of control over the trustee and the affairs of the trust.

The business of the trust is the management of real estate, making and renewing leases, collecting rents, paying taxes and insurance, maintaining the property in repair, providing heat, light, elevator and janitor service, and in general doing those things incident to the management of business property. Net rentals are distributed according to the ownership of record of the shareholders. The buildings

and property owned are used for offices, storage lofts, and such other business purposes as city property in the locality is used. The trustees held in addition to real estate a note secured by a real estate mortgage for \$157,000. No meetings of shareholders have been held. There has been no amendment to the trust instrument nor has there been a removal of any trustee acting under the instrument (p. 67).

The shares are by the agreement declared to be personal property entitling the holders thereof to a division of profits and to an ultimate division of the proceeds of the property. The shareholders have no other interest in the property itself, either real or personal, and no right to call for any partition thereof. The death of a shareholder during the continuance of the trust shall not determine the trust nor entitle his legal representatives to an accounting (p. 55). During each year the trustees have made a report of income received to the collector of internal revenue upon the forms used by corporations and have paid a tax upon the income in the same manner as a corporation pays a tax on its income. The shareholders individually have reported in their income-tax returns the dividends received from the trust in the same manner as dividends received from a corporation, and have deducted these dividends in the same manner as dividends from a corporation would be deducted in computing their individual normal tax (p. 68, 89).

### **The Haymarket Trust.**

In September, 1900, the joint owners of a piece of real property in Boston gave to a broker named Burroughs an option to purchase the property, subject to an existing mortgage of \$180,000, for \$245,000. The property was at that time rented to a number of tenants who used it for store and office purposes, the owners furnishing heat, water, light, janitor and elevator service. Burroughs suggested to one Bryant the purchase of this property as trustee and that the funds be secured by subscription from persons who would hold the beneficial interest in the property. The proposition was that he secure \$250,000, which would include \$5,000 over the purchase price to cover initial expenses. Bryant and one Sweetser consented to act as trustees, and Burroughs assigned his option to Bryant and Sweetser. Thereafter a document called an agreement and declaration of trust was signed by Bryant and Sweetser as trustees, and at about the same time by them as subscribers or shareholders, with the amount of their subscriptions or shares set opposite their names, and also by 27 other persons, with the amount of their subscriptions set opposite their names. Thereafter the option obtained by Burroughs was exercised, and Bryant and Sweetser called upon the subscribers to pay the amounts of their subscriptions. This was done, and on January 1, 1901, a deed was passed conveying the property to Bryant and Sweetser as trustees of the Haymarket Trust. Burroughs received a commission from the

vendors and, in addition, \$2,500 from the trustees for obtaining subscriptions to the shares to be issued under the agreement (p. 8).

Each subscriber received a certificate. The form of certificate with the power of attorney for transfer is printed on page 12 of the record. The original trustees and their successors have continuously managed the property in accordance with the agreement. They have paid the interest on the mortgage, provided service for the tenants, made repairs, collected rents, made leases, and performed all other duties incident to the management of a store and office building. They have periodically distributed to the shareholders the net income, with the exception of \$20,000 used to liquidate a portion of the mortgage indebtedness, \$60,000 invested in railroad bonds, and \$15,000 invested in Liberty bonds, which they now hold as a general reserve fund. The trustees receive as compensation for their services 5 per cent of the total yearly income. The trustees have made up annual statements, examples of which appear on pages 13 and 14 of the record.

There has been an annual meeting of shareholders each year, and in connection therewith proxies have been sent to the shareholders for their use in the event that they could not be present. The record book kept by the trustees contains records of the annual meetings of the shareholders (p. 10). At the annual meetings the shareholders have on

three occasions filled vacancies in the office of trustees. In two cases the vacancy was caused by death, and in the other case by resignation (p. 10). At one annual meeting of the shareholders the date of the annual meeting was changed from the second Wednesday in December to the third Wednesday of January. At the annual meetings the shareholders would approve the annual report of the trustees. The right to transfer a shareholder's interest has been largely exercised, and about one-half of the original shareholders have transferred their shares. Whenever there has been a transfer, a new certificate has been issued designating the number of shares owned by the new shareholder (p. 10).

Under the agreement the trustees have general authority to manage the property (pp. 25, 26). During periods of construction interest at the rate of 4 per cent per annum "on the amount of new stock sold for the purpose of such construction" shall be added to the cost of the buildings and paid to the purchasers of said stock (p. 26). The shareholders shall not be liable for any assessment, and the trustees shall have no power to bind them personally (p. 27).

The agreement requires the trustees to call annual meetings of the shareholders and permits them to call special meetings, and requires them to do so upon written request of the holders of one-twentieth of the shares outstanding. In notices of special meetings the purpose thereof shall be stated (p. 28)

At any annual meeting, or special meeting called for the purpose, *the holders of a majority of the entire number of shares may fill any vacancy existing in the number of trustees, may depose any or all of the trustees and elect others in their places, may authorize the sale of the property or any part thereof, and may alter or amend the agreement.* For all other purposes a majority of those shareholders may decide on matters particularly coming before them. Shareholders may vote by proxy, and each share shall be entitled to one vote. At any meeting five shareholders, or their proxies, representing one-fifth of all the shares outstanding, shall constitute a quorum. A certificate signed by the chairman of any meeting, countersigned by one or more of the trustees, shall be conclusive evidence of the regularity of that meeting and of any vote passed at such meeting and of all facts stated in such vote or certificate (p. 28). The trust shall continue for twenty years after the death of the last surviving original subscriber and six other named persons unless sooner terminated by the acts of the trustees or shareholders (p. 29). The certificates have a par value of \$100 each (p. 12).

#### THE STATUTES.

The pertinent parts of the statutes involved herein are as follows:

Revenue Act of 1916 (39 Stat. 756):

SEC. 407. That on and after January first, nineteen hundred and seventeen, special taxes shall be, and hereby are, imposed annually, as follows, that is to say:

Every corporation, joint-stock company or association, now or hereafter organized in the United States for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States, or any State or Territory of the United States, shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company or association, or insurance company, equivalent to 50 cents for each \$1,000 of the fair value of its capital stock and in estimating the value of capital stock the surplus and undivided profits shall be included: \* \* \* The amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year: *Provided*, That for the purpose of this tax an exemption of \$99,000 shall be allowed from the capital stock as defined in this paragraph of each corporation, joint-stock company or association, or insurance company: \* \* \* (p. 789).

Revenue Act of 1918 (40 Stat. 1057):

SECTION 1. That when used in this Act—

\* \* \* \* \*

The term "corporation" includes associations, joint-stock companies, and insurance companies;

The term "domestic" when applied to a corporation or partnership means created or organized in the United States; \* \* \* (pp. 1057, 1058).

SEC. 1000. (a) That on or after July 1, 1918, in lieu of the tax imposed by the first subdivision of section 407 of the Revenue Act of 1916—

(1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business equivalent to \$1 for each \$1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of \$5,000. In estimating the value of capital stock the surplus and undivided profits shall be included; \* \* \* (p. 1126).

(c) The taxes imposed by this section shall not apply \* \* \* to any corporation enumerated in section 231 (p. 1126).

SEC. 231. That the following organizations shall be exempt from taxation under this title—

\* \* \* \* \*

(12) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; \* \* \* (p. 1076).

SEC. 1004. That if the tax imposed by section 407 or 408 of the Revenue Act of 1916 for the fiscal year ending June 30, 1919, has been paid by any person subject to the corresponding tax imposed by this title, collectors may issue a receipt in lieu of special tax stamp for the amount by which the tax under this title is in excess of that paid or payable

and evidenced by stamp under the Revenue Act of 1916. \* \* \*

If the corresponding tax imposed by section 407 of the Revenue Act of 1916 was not payable by stamp, the amount paid under such section for any period for which a tax is also imposed by this title may be credited against the tax imposed by this title (p. 1129).

The only claim made by the petitioners is that they are not "associations" within the meaning of the statutes, and it is not claimed that there is any essential difference in the meaning of the word as used in the two statutes.

The difference between these cases and the case of *Crocker v. Malley*, No. 587 on the docket this term, is that in the *Crocker* case the petitioners admit that they are an "association," but claim that they have no "capital stock."

#### ARGUMENT.

**Both the Hecht and the Haymarket Trusts are associations within the meaning of the Revenue Acts of 1916 and 1918.**

- (a) The history of the statutes and applicable decisions show the purpose of Congress to include nonstatutory organizations.

Taxation of this general kind began with the passage of the Act of August 5, 1909, 36 Stat., section 38, page 112, which imposed a tax "on every corporation, joint-stock company or association organized for profit and having a capital stock represented by shares, and every insurance company now or hereafter organized under the laws of the United States or of any State or Territory of the United

States or under the acts of Congress applicable to Alaska or the District of Columbia \* \* \* with respect to the carrying on or doing business by such corporation, joint-stock company, or association," based upon net income. This statute was attacked as an income tax and therefore unconstitutional, but it was sustained by this court as an excise tax. *Flint v. Stone Tracy Company*, 220 U. S. 107. In *Eliot v. Freeman*, 220 U. S. 178, this court at the same time held that the Act of 1909 did not apply to two typical Massachusetts real estate trusts on the ground that the language of the act imported organizations deriving power from statutory enactment. Mr. Justice Day, in delivering the opinion of the court, said, at pages 186 and 187:

The language of the act "\* \* \* now or hereafter organized under the laws of the United States," etc., imports an organization deriving power from statutory enactment. The statute does not say under the law of the United States, or a state, or lawful in the United States or in any state, but is made applicable to such as are organized under the laws of the United States, etc. The description of the corporation or joint-stock association as one organized under the laws of a state at once suggests that they are such as are the creation of statutory law, from which they derive their powers and are qualified to carry on their operations.

\* \* \* \* \*

Entertaining the view that it was the intention of Congress to embrace within the cor-

poration tax statute only such corporations and joint-stock associations as are organized under some statute or derive from that source some quality or benefit not existing at the common law, we are of opinion that the real estate trusts involved in these two cases are not within the terms of the act.

That decision was rendered March 13, 1911. The Circuit Court of Appeals in the cases at bar held that the language of the statutes of 1916 and 1918 was intended to avoid the result reached in *Eliot v. Freeman*, and that that case, therefore, was not applicable. It seems plain that Congress in enacting the Act of 1916 had in mind the decision of this court in *Eliot v. Freeman*, in providing for taxes upon corporations, joint-stock companies, and associations, when it used the language "now or hereafter organized in the United States," omitting all reference to the "laws of the United States or of any state or territory"; but when it mentioned insurance companies, it made them taxable when organized "under the laws of the United States, or any state or territory of the United States." It would seem that Congress deliberately drew a distinction between insurance companies and the other organizations, and with respect to the latter deliberately omitted the words which this court held in *Eliot v. Freeman* limited organizations taxed to those organized under statutes, and substituted the all-inclusive words "organized in the United States." When we examine the Act of 1918 this becomes even

more apparent, for section 1 of that Act defines the term corporation as including associations, joint-stock companies, and insurance companies, and the term domestic, when applied to a corporation, as meaning created or organized in the United States. It would seem clear, therefore, that Congress intended the tax imposed by the Act of 1916 to apply to all associations organized in the United States for profit and having a capital stock represented by shares, no matter how organized, while the Act of 1918 was even broader and imposed the tax upon every corporation and association created or organized in the United States.

The Act of October, 1913, 38 Stat. 114, 166, imposed the first income tax and dropped the excise tax on corporations and made them subject to the income tax. Section 2, paragraph G, defined the corporations subject thereto as every corporation, joint-stock company or association and every insurance company organized in the United States, "no matter how created or organized."

The application of this section to a Massachusetts trust was considered by this court in *Crocker v. Malley*, 249 U. S. 223. In that case taxes had been assessed upon the theory that the plaintiffs were an association. This court held that they were not. The facts in that case, as set forth in the syllabus, were as follows:

The shareholders of a milling company, preliminary to winding it up, caused its active property to be conveyed and its other realty

to be leased to a new corporation, the shares of which were left with persons who also were granted the fee of the leased property, upon a trust, designated by a name, in which the equitable interests were divided ratably among the original shareholders, and evidenced by separable and transferable certificates. The trustees were to hold the trust property upon trust to convert it into money and distribute the proceeds at a time left to their discretion, within 20 years after death of specified living persons, and in the meantime were to have the powers of an owner, distributing what they determined to be fairly distributable net income among the beneficiaries, and applying funds to repairs or development of the property or the acquisition of new, pending conversion and distribution. Their compensation, beyond a stated percentage, was not to be increased, nor were vacancies to be filled or the trust terms modified, without the consent of a majority in interest of the beneficiaries acting separately, who, in other respects, had no control, and were declared to be "trust beneficiaries only, without partnership, associate or any other relation whatever *inter sese*." *Held*, that neither the trustees nor the beneficiaries, nor all together could be regarded as a joint-stock association, within the meaning of § II, G (a), of the Income Tax Law of October 3, 1913; and that dividends upon the stock left with the trustees were not subject to the extra tax imposed by that section (p. 232).

This court, in an opinion by Mr. Justice Holmes, held that "There can be little doubt that in Massachusetts this arrangement would be to create a trust and nothing more" (p. 232). The reason for that conclusion seems to have been that the shareholders had no real control over the trust estate. Under the income tax law fiduciaries were not required to pay the tax upon dividends of a corporation that itself paid an income tax, but corporations, joint-stock companies, and associations were required to pay such tax. The conclusion of this court was thus expressed:

Upon the whole case we are of opinion that the statute fails to show a clear intent to subject the dividends on the Massachusetts corporation's stock to the extra tax imposed by G (a).

The court did not, however, base its decision upon the fact that the trust was not created or established pursuant to any statutory law.

The Act of October 22, 1914, 38 Stat. 745, 775, imposed a stamp tax on each original issue of certificates of stock "by any association, company, or corporation." The Circuit Court of Appeals for the First Circuit held in *Malley v. Bowditch*, 259 Fed. 809, that such tax was applicable upon the original issue of certificates of shares of the Pepperell Manufacturing Company, an organization in the form of a trust and deriving none of its rights from any statute. These various acts of 1914, 1916, and 1918 adopted the same broad phrasing as to companies

and associations organized in the United States, thus showing the continuing legislative purpose to avoid the limitation found by that court in *Eliot v. Freeman* to arise out of the language "organized under the laws of the United States or of any State," etc.

The difficulty with the "trust" considered in *Eliot v. Freeman* was that it was not a statutory "association." That difficulty has been removed by statute.

The difficulty in *Crocker v. Malley* was that the organization was a "trust," not an "association."

The organizations now before the Court are not trusts but "associations."

(b) Organizations of this character under the Massachusetts law.

The courts of Massachusetts have divided organizations of this general character into two classes:

First. Strict trusts; and

Second. Those which are not strict trusts but which for many purposes, such as the place of local taxation and individual liability of members, are classed as partnerships.

There would seem to be no doubt that the courts of Massachusetts would hold that this was not a strict trust.

*Williams v. Milton*, 215 Mass. 1.

*Frost v. Thompson*, 219 Mass. 360.

*Dana v. Treasurer*, 227 Mass. 562.

*Priestley v. Treasurer*, 230 Mass. 452.

*Horgan v. Morgan*, 233 Mass. 381.

*Williams v. Milton*, 215 Mass. 1, is the leading case in Massachusetts on the distinction between the two classes into which may be divided organizations of the general character of those here in question. In some cases where trustees hold property the beneficial interest of which is in shareholders, the arrangement constitutes a trust. In another class of cases the arrangement is held to be not a trust but a partnership. The distinction seems to depend upon the control exercised by the shareholders or stockholders upon the trustees. If the trustees are the absolute masters of the property and the shareholders have no voice in the management and no rights except to have the property managed for their benefit, a trust exists. If, on the other hand, the shareholders may exercise control by reason of power reserved to them in the instrument under which they act to appoint or remove trustees, to give direction to the trustees or to alter or terminate the trust, then it is not a strict trust but the trustees are in effect agents for the stockholders in the management of their property.

In *Dana v. Treasurer*, 227 Mass. 562, the court said:

The Amoskeag Manufacturing Company was the name by which the trustees under a declaration of trust were to be known in their collective capacity as a matter of convenience in the practical conduct of the business carried on by them under that declaration of trust. The trust was created to take over the factory and manufacturing business theretofore owned and carried on by a New Hamp-

shire corporation known as the Amoskeag Manufacturing Company. The factory in question and the tangible personal property held under the trust are situate in the State of New Hampshire. "The beneficial interest in this trust" is divided into shares. These shares are represented by transferable certificates. It is provided in the declaration of trust that the death of a shareholder shall not operate to determine the trust nor entitle the legal representatives of a deceased shareholder to an accounting, but that the executors, administrators, and assigns of the deceased shareholder shall succeed to the rights of the decedent and be entitled to a certificate in their own names upon surrender of the old certificate. It is also provided therein that the ownership of shares thereunder shall not entitle the shareholder to any title in or to the trust property or right to call for partition or division of the same, or for an accounting. The declaration of trust provides for meetings of the shareholders, and that at these meetings the shareholders shall have power to elect the trustees and to alter and amend the declaration of trust. It is further provided therein that on the expiration of twenty-one years after the death of certain persons therein named the trustees shall wind up the affairs of the trust, liquidate its assets, and distribute the same among the holders of shares. There is a provision in it whereby the time for winding up its affairs can be shortened or extended by the shareholders at shareholders' meetings. In addition there is a provision which au-

thorizes the trustees in case they elect so to do "to distribute shares, securities, or obligations instead of cash" in case of the liquidation of the assets of the trust. But there is no provision authorizing them to distribute among the shareholders the real property of the trust.

This declaration of trust created a partnership. Upon that point *Phillips v. Blatchford*, 137 Mass. 510, is decisive. In addition the trust is well within the distinction between trusts which create partnerships and trusts which are pure trusts, stated at length in *Williams v. Milton*, 215 Mass. 1, where the cases are collected (pp. 564, 565).

In *Opinion of Justices*, 196 Mass. 603, a majority of the justices of the Supreme Judicial Court, in response to a request from the legislature for their opinion, advised that the legislature had power to enact a law imposing a tax on sales of shares or certificates of stock in any domestic or foreign association, company, or corporation. Justice Rugg, in his opinion, said:

The device of voluntary unincorporated associations, with complicated contractual provisions for the transfer of fractional interests therein by certificates, depending for their validity upon an elaborate and intricate trust agreement, for the enforcement and interpretation of which resort is frequently and necessarily had to the courts, does not belong to that class of natural rights which is above the power of the Legislature (p. 620).

These associations have long been recognized as *quasi* corporate in form. In 1904 Chief Justice Knowlton, in *Hussey v. Arnold*, 185 Mass. 202 said:

The agreement creating the trust has peculiar provisions. The object of it, apparently, was to obtain for the associates most of the advantages belonging to corporations, without the authority of any legislative act, and with freedom from the restrictions and regulations imposed by law upon corporations.

The Legislature of Massachusetts has given to these associations a statutory status. General Laws of Massachusetts, 1921, ch. 182, codifying earlier legislation of 1909, 1913, 1914, 1915, and 1916. See also chapter 368 of Acts of 1921. Chapter 182 of the General Laws is entitled "Voluntary Associations," and is included in Title XXII entitled "Corporations." By section 1 association is defined as "a voluntary association under an original instrument or declaration of trust, the beneficial interest under which is divided into transferable certificates of participation or shares." By section 2 it is provided that the instrument creating the association shall be filed with the Commissioner of Corporations and with the clerk of every town where such association has the usual place of business. Section 5 requires the Commissioner to transmit to the Secretary of State copies of such instruments. Sections 3, 4, and 7 to 11 deal especially with associations owning stock of public utility

companies. Section 6, a reenactment of the Act of 1916, chapter 184, provides:

An association may be sued in an action at law for debts and other obligations or liabilities contracted or incurred by the trustees, or by the duly authorized agents of such trustees, or by any duly authorized officer of the association, in performance of their respective duties under such written instruments or declarations of trust, and for any damages to persons or property resulting from the negligence of such trustees, agents, or officers acting in the performance of their respective duties, and its property shall be subject to attachment and execution in like manner as if it were a corporation, and service of process upon one of the trustees shall be sufficient.

By this provision such an association may be sued, and its property is liable to attachment and execution as if it were a corporation. Of course, the court is not now concerned with anything except the status of these assessments under the federal revenue act. If these organizations are described by the statute of the state under which they exist as associations, and if its statute has made them liable to ordinary creditors in the same manner as corporations, must it not be held that they have at least a *quasi* corporate character and, if they are associations within the meaning of the Massachusetts statutes, that they are also associations within the meaning of the revenue act? If they are liable under Massachusetts statutes to creditors as though corporations, why are

they not liable to taxation under federal statutes imposing taxes on corporations, joint-stock companies, and associations? In the *Associated Trust Case*, 222 Fed. 1012, Judge Morton in the District Court for the District of Massachusetts held that an association of this general character was an unincorporated company within the meaning of the Bankruptcy Act, and so subject to involuntary bankruptcy.

In that case the court said (pp. 1013, 1014):

The character of the respondent is to be gathered from the trust deed. Under it the trustee declared that he would take and hold in trust money paid to him by other persons to the amount of \$1,000,000, for which he would issue transferable certificates having a face value of \$100, entitled to interest, and to participate in surplus earnings, and also entitled to borrow from the trust 60 per cent of the face value of the certificate, and after five years to receive from the trust in cash the face value of the certificate upon the surrender thereof. The trustee is given very broad powers as to the management of the property in which the trust funds are invested, with the right to determine what part of the income shall be divided and what shall be retained as surplus. He has no power to bind any of the certificate holders; and they have no power to interfere directly in the management of the property, and no title to it. A "board of directors" is provided for, who may be appointed by the trustee and are removable by him; their duties are merely to advise the trustee;

they are negligible as to the questions here raised. Up to this point there would seem to be nothing in the organization differentiating it under the Massachusetts decisions from what may be called an ordinary trust; that is, the beneficiaries, cestuis, or certificate holders (whichever they may be called), have no interest in the trust property and no right of joint action for control of it. They are in substance like beneficiaries in a trust under a will. There is no organization having a distinct entity apart from the trustee.

After pointing out that the words "unincorporated company" were not found in any Massachusetts statute and that their meaning in the Bankruptcy Act was by no means certain, Judge Morton concluded that they would seem to imply an association of individuals, and not partners, carrying on business under a distinct name and having common rights *inter se* and having no individual ownership in joint property, no individual control over the business, and no direct individual liability for the company's debts, and that the word "unincorporated" would seem to imply that the organization should have some of the attributes usually found in corporations. From an examination of the declaration of trust it appeared that the character, scope, and size of the enterprise could be changed by the certificate holders and that it could be terminated by them. He concluded that the absolute powers of termination and amendment gave to the certificate holders the ultimate control of

the business whenever they chose to take that matter into their hands, and he said (pp. 1014, 1015):

The analogy between the respondent organization and a corporation is apparent. The certificate holders clearly possess many of the most characteristic powers of stockholders. If the expression "unincorporated company" in the Bankruptcy Act does not describe such an organization as the respondent, it is difficult to see what meaning can be given to those words. To hold the respondent a partnership within the Bankruptcy Act would lead to results never contemplated by anybody, and would impose upon the certificate holders obligations which neither they nor the creditors of the trust supposed existed. It would be a very unjust result. To hold that the respondent is not an organization, and is nothing more than a strict trust, is almost as far from the fact as to hold it to be a partnership. These certificate holders voluntarily united into a business organization, in which they invested their money under a contract by which they acquired certain individual rights against the trustee, and certain other rights to be exercised by joint action of all the certificate holders. "Unincorporated company" seems to me exactly to describe what the respondent is.

See also *In re Seaboard Fire Underwriters*, 137 Fed. 987.

Judge Page, in the District Court in Illinois, in *Chicago Title and Trust Company v. Smietanka*, 275 Fed. 60, held that a certain voluntary associa-

tion was an "association" within the meaning of the Income Tax Act of October 3, 1913. It was urged that the case presented a trust similar to that considered by this court in *Crocker v. Malley*, 249 U. S. 223. Judge Page, after considering the decision in that case and in *Eliot v. Freeman*, 220 U. S. 178, 226, held that there were material differences between the trust involved in that case and the one involved in *Crocker v. Malley*. He held that the so-called trustees were not principals but were mere agencies of the other persons interested. With respect to the contention of counsel that, if the organization became an association, it thereby necessarily became a partnership, he says: "There are, in my opinion, certain limits or conditions that prevent the agreement here from creating an ordinary partnership."

The decisions of the Massachusetts courts seem to have established the principle that if shareholders have power of control that alone is sufficient to take the organization out of the class of strict trusts.

In *Sears' Trust Estates as Business Companies* the author, dealing with the legal status of organizations created under declarations of trust where trustees hold title and carry on business for the benefit of the owners of transferable shares, says:

Therefore it seems dangerous for any trust instrument to provide for any legal effect to arise out of any action taken by certificate holders. The purpose should be, if it is desired to establish a true trust, that the shareholders should have nothing more than

a common interest in its profits, without any possibility of concert of action between them to affect any legal or binding result. The trustees must be masters as absolute as if they were the sole legal owners, and without being liable to respond to any ulterior demand from any source while the trust lasts, if they stipulate not to be personally liable. (P. 172; see also pp. 144, 369.)

(c) Application of the law to the facts with respect to the Hecht and Haymarket Trusts.

The facts relating to these two organizations show plainly that they would not be regarded as trusts within the doctrine of the Massachusetts and other decisions heretofore cited. In the case of the Hecht Trust, the real seat of power is with the shareholders and not with the trustees. The shareholders may at any time control the action of the trustees by their power to increase the number of trustees, to remove trustees, to modify the declaration of trust in any particular, to give binding instructions to the trustees, and to terminate the trust at will. Plainly this trust is *quasi* corporate in form and power, and is an association within the meaning of the revenue acts.

In the case of the Haymarket Trust this *quasi* corporate character is even more obvious.

The Haymarket Trust has almost all the elements of a corporation in its organization and form. It secured its money by soliciting subscriptions from the public, and the declaration of trust provides machinery and proceedings closely resembling an ordi-

nary corporation. The stockholders are clearly the masters. There have been annual meetings of shareholders with power to vote by proxy. Vacancies in the trustees have been filled by election at the annual meetings of shareholders. The agreement provides for the sale of new stock. There is freedom from personal liability. The trustees are required to call annual meetings and special meetings on request, and at these meetings vacancies in the trustees may be filled, any or all the trustees may be removed, the sale of the property of the association may be authorized, and the agreement may be altered or amended. Shareholders representing one-fifth of all the outstanding shares shall constitute a quorum. Under any ordinary construction of the word this is clearly an association of men engaged in a common purpose with money subscribed by them for profit. It is a matter of common knowledge that this form of enterprise has, in recent years, been looked upon with great favor and has been largely resorted to for the obvious purpose of avoiding the difficulties and restraints which corporation laws have imposed. It is really a device under which parties may make their own corporation code and amend it as they choose, without interference by the legislature, as is pointed out in the opinion of the Circuit Court of Appeals. Two substantial textbooks have, within recent years, been written on the law concerning such organizations and dealing with their advantages for general business purposes. See *Sears, Trust Estates as Business Companies*, 1st ed. 1912, 2d ed.

1921, and Wrightington on *Unincorporated Associations*, 1916.

The association considered in *Dana v. Treasurer*, 227 Mass. 562, was the Amoskeag Manufacturing Company, well known as one of the largest business enterprises in New England. The Pepperell Manufacturing Company, before the Circuit Court of Appeals in *Malley v. Bowditch*, 259 Fed. 809, had a capitalization of over \$7,500,000, and the Crocker Trust, now admitted to be an "association," which was evolved from the Wachusett Realty Trust, involved in *Crocker v. Malley*, 249 U. S. 223, operates large paper manufacturing mills employing about 1,000 men and has gross assets of over \$10,000,000.

In the preface of Wrightington on *Unincorporated Associations*, the author says:

One of the most striking features of the recent decisions of the Courts is the evidence that business men are reverting to unincorporated associations to carry out their purposes. Owing to peculiar local restrictions on corporations these associations have been more largely used and more highly developed in Massachusetts than elsewhere. To them the lawyers of other States are now turning for relief. These associations are organized under the terms of elaborate trust deeds and resemble closely the important features of corporations.

The fact that these organizations might be classed for certain purposes in Massachusetts as partnerships does not mean that they may not be classed as associations for purposes of taxation under the federal

law. The point is that they are not trusts and would not be so classed in Massachusetts. Indeed, classification as partnerships would be the last thing which the petitioners would wish. As the Circuit Court of Appeals said (p. 89):

Manifestly, counsel would depreciate such result \* \* \*. Their quest is tax exemption, not tax substitution.

The fact that an organization may be a partnership for certain purposes does not prevent it from being an association, joint-stock company, or company, nor does the fact that it may be an association or joint-stock company prevent it from being classed as a partnership for certain purposes. In *Claggett v. Kilbourne*, 1 Black, 346, this court said:

An association or joint-stock company was formed in 1836 by several persons \* \* \* for the purpose of dealing in the purchase and sale of lands in the State of Iowa \* \* \*.

By the Articles of Association the lands purchased were to be conveyed to certain trustees named, to hold as joint tenants in trust for the benefit of the persons composing the Association. The stock or capital was divided into forty-eight shares, and held in unequal parts by the stockholders representing the moneys paid into the association. \* \* \*

The *joint-stock company*, of which the judgment debtor in this case was a member, constituted a *partnership* for the purpose of dealing in real estate; and the law governing the rights of creditors, representing the separate debts of a partner, must determine the

rights of the plaintiff (pp. 346-348). (*Italics ours.*)

In *Chapman v. Barney*, 129 U. S. 677, this court in holding that the United States Express Company, a joint-stock company organized under the law of the State of New York, was not a citizen for the purposes of the jurisdiction of the federal courts, said (p. 682):

In fact, the allegation is that the company is not a corporation but a joint-stock company—that is, a mere partnership.

So in New York the Court of Appeals has said, referring to joint-stock companies or associations, that such associations "were not corporations, but mere partnership concerns." *People v. Coleman*, 133 N. Y. 279. Whatever such associations may be for certain purposes, it is clear they are not partnerships in the ordinary sense of the word. No individual member has power to bind the association. The death of a member does not end it, nor does the transfer of his interest. And the interest of any member may be transferred without the consent of the other members by the sale of his stock; and it would seem to be possible, as in the case of the Haymarket Trust, to include in the declaration of trust provisions practically freeing an individual member from personal liability. For practical purposes these associations have most of the advantages and privileges of regularly organized corporations, without their disadvantages. That is, of course, the reason why they are organized—to secure advantages and avoid disadvantages. While it is

common to speak of the "privileges" enjoyed by corporations, the tendency to regulate corporations by law has resulted in turning most of these so-called privileges into liabilities. Associations now enjoy the privilege looked upon by many as the greatest privilege of corporate organizations; that is, the power to obtain money from the public on transferable shares, which are readily transferable and, in the case of many of the Massachusetts associations, have a recognized market value and a ready market, and are looked upon by the investing public as attractive forms of investment. If they could escape taxation, they would be even more attractive and would enjoy a privilege which is not the lot of corporations in this day.

There is no reason to assume that Congress should have desired to favor organizations of this kind by exempting them from taxation to which their competitors in corporate form are subjected. It would be hard to find any practical reason why Congress should have intended to exempt from taxation such concerns as the Amoskeag Manufacturing Company and the Pepperell Manufacturing Company, when their competitors in the same business, organized as corporations, are taxed.

## CONCLUSION.

We can not do better than summarize by adopting the conclusion of the Circuit Court of Appeals:

The natural interpretation of the language used in the Acts of 1916 and 1918 would include plaintiff's organizations as associations.

The contrast between the language used in the Act of 1909 "organized under the laws of the United States or any State," etc., and in the Acts of 1916 and 1918 "organized in the United States," shows that Congress intended to avoid the result reached in 1911 by the Supreme Court in *Eliot v. Freeman*.

The manifest general purpose of Congress was to tax business deriving powers and making profits from association, particularly business done by organizations getting all or a substantial part of their capital on transferable shares, such as are commonly sold to the investing public.

Prior to the passage of either the Revenue Act of 1916 or 1918, the Massachusetts Legislature had by the Acts of 1909 and 1914 expressly recognized such organizations as associations. Congress used the word "association" as the Massachusetts Legislature had previously defined and used it.

By the Act of 1916, the Massachusetts Legislature made such associations liable to creditors in like manner as if corporations; by analogy they have similar liability to the Federal Government for taxes.

The case of *Malley v. Crocker*, 249 U. S. 223, makes, on analysis of the Wachusett

Trust and the reasoning of the court, not for the plaintiffs but for the government. One ground of that decision was to avoid unjust, discriminatory, double taxation; whereas to sustain the plaintiff's contention would create discriminatory immunity for a large class of business organizations, thus giving them an unfair advantage over their incorporated competitors.

The judgment of the Circuit Court of Appeals should be affirmed.

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